

A MARKETING PLAN FOR A NEW PRODUCT LAUNCH -
NON-PROPORTIONAL FACULTATIVE REINSURANCE
FOR ENGINEERING INSURANCE BUSINESS IN HONG KONG

by

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ABSTRACT

Reinsurance begins to play a more important role behind the issuance of an insurance policy covering particularly a jumbo construction project, like the construction project of the Hong Kong new airport. Without the presence of reinsurance, an insurance company can never afford to pay a billion loss in case of an occurrence of a catastrophic event.

Nevertheless, having faced keen competition, insurance in particular to reinsurance for engineering insurance business have not been profitable for the past few years. There are also quite some inherent problems due to the peculiar nature of business, apart from competition, aggravating the loss situation.

A lot of work have been devoted in my following study to identify a niche market, which is not totally satisfied yet by the present reinsurance services offered in the market and where a new reinsurance product - non-proportional engineering facultative reinsurance - can really fill in to bring profitability to both insurance as well as reinsurance industry within this niche market in a longer term. The niche market under my study is the large locally incorporated insurance companies and the new product is considered to be offered by the Hypotheti-

cal Reinsurance Company. The work in my study includes a careful analysis over the Hypothetical Reinsurance Company and market opportunities, potential profile of insurers, including the large locally incorporated insurance companies, and competitive environment on the new product.

In view of the unsatisfied needs identified, the strengths of the Hypothetical Reinsurance Company and the possible competition to be encountered, essential components about the launch of the new product are developed, particularly over the areas of product, price, promotion, sales force and distribution, and tested with some selected companies within the niche market. Results are carefully analyzed and finally compiled to derive a marketing plan to assist the launch of the new product. Detailed objectives and strategies have been set over the areas of product, price, promotion, sales force and distribution respectively.

NOTICE OF CONFIDENTIALITY

All the information contained in this report are strictly confidential and some were contributed by few companies who are not willing to be named.

The author therefore requests the report to be kept in the confidential file and not to be released without prior consultation and approval from the author.

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PREFACE

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CHAPTER I

INTRODUCTION

Risk

Risk can be defined as the uncertainty of loss. The emphasis on the word 'loss' in our definition of risk highlights the fact that we are concerned with those risks which hold out the prospect of some loss that is capable of financial measurement. On this basis, risk can be classified as either pure risk (where the outcome could be either a loss or a break-even situation) or speculative risk (where the outcome could be a loss, a break-even or a profit situation).

Insurance

Insurance is mainly considered as a risk transfer mechanism, whereby the individual or the business enterprise, we collectively call the insured, can shift some of the uncertainties on life to the shoulders of others. In return for a known premium, usually a very small amount compared with the potential loss, the cost of that loss can be transferred to an insurer, who issues an insurance policy. In short, the primary function of insurance is to provide a risk transfer mechanism by

means of a common pool into which each insured pays a fair and equitable premium, according to the risk of loss he or she brings to the pool.

There are certain criteria to be met in order to enable a risk to be insurable as follows:

- insurance is concerned only with pure risks while speculative risks, where there is the possibility of some gain, cannot be insured
- there must be a large number of similar and homogeneous risks before any one of that number is capable of being insured
- the risk must involve a loss that is capable of financial measurement so that monetary compensation can be allowed following a loss
- the premium must be seen to be reasonable in relation to the likely financial loss
- the loss must be entirely fortuitous as far as the person seeking insurance is concerned
- the risk that is to be insured must result in some form of financial loss and the person insuring must be the one who stands to suffer some financial loss if the risk materializes
- it is the common principle in law that contracts must not be contrary to what the society considers the right

and moral thing to do

According to the Insurance Companies Ordinance (1983 ed), insurance business can be classified as long term insurance business or general insurance business. Long term insurance business is further divided into 6 different sub-classes, namely (1) life and annuity, (2) marriage and birth, (3) linked long term, (4) permanent health, (5) tontines and (6) capital redemption respectively. Similarly, general insurance business is further divided into 17 different sub-classes, including (1) accident, (2) sickness, (3) land vehicles, (4) railway rolling stock, (5) aircraft, (6) ships, (7) goods in transit, (8) fire and natural forces, (9) damage to property, (10) motor vehicle liability, (11) aircraft liability, (12) liability for ships, (13) general liability, (14) credit, (15) suretyship, (16) miscellaneous financial loss and (17) legal expenses respectively.

Engineering Insurance

Engineering insurance business should be considered as a different form of classification under general insurance business, possibly involving mainly 4 different sub-classes, namely, (8) fire and natural forces, (9) damage to property, (13) general liability and (16) miscellaneous financial loss respectively according to the classification of the Insurance Companies Ordinance. For the ease of discussion, the full nature of business

dealt with in each of the above 4 sub-classes is produced as below:

- (8) fire and natural forces

... effecting and carrying out contracts of insurance against loss of or damage to property (other than property to which classes 3 to 7 above relate) due to fire, explosion, storm, natural forces other than storm, nuclear energy or land subsidence

- (9) damage to property

... effecting and carrying out contracts of insurance against loss of or damage to property (other than property to which classes 3 to 7 above relate) due to hail or frost or to any event (such as theft) other than those mentioned in class 8 above

- (13) general liability

.... effecting and carrying out contracts of insurance against risks of the persons insured incurring liabilities to third parties, the risks in question not being risks to which class 10, 11 or 12 above relates

- (16) miscellaneous financial loss

.... effecting and carrying out contracts of insurance against any of the following risks, namely -

a) risks of loss to the persons insured attributa-

ble to interruptions of the carrying on of business carried on by them or to reduction of the scope of business so carried on

- b) risks of loss to the persons insured attributable to their incurring unforeseen expense
- c) risks neither falling within paragraph (a) or (b) above nor being of a kind such that the carrying on of the business of effecting and carrying out contracts of insurance against them constitutes the carrying on of insurance business of some other class

Under the existing market situations, there are still various types of insurance policies classified as engineering insurance business listed as follows:

(1) construction insurance

Construction insurance policy is usually arranged by the employer (who commissions the contract works), the contractor (who carries out the contract works) or the nominated sub-contractors (who is appointed to carry out some specialist works, like lift installation works, air-conditioning installation works, etc.) satisfying the contractual requirement laid down in a building or civil engineering construction contract (like construction of buildings, dams, highways, reservoirs or tunnels, etc.) to cover risks arising out of the performance of the

contract causing possible loss of or damage to the following items:

- contract works
- third party property
- third person
- anticipated profits due to the fact that loss of or damage to part of the contract works leads to unavoidable delay in completion of the contract

Construction insurance falls within the definition of all the above 4 sub-classes. A simple example will be the construction of a commercial building. The contract works will then be the commercial building itself. The third party property, like adjacent buildings, may be damaged or the third persons, like walking-by pedestrians, may be injured due to the performance of the contract, say by the falling objects. Moreover, anticipated profits, such as the rental income after the opening of the commercial building, may be affected if delay is caused by loss of or damage to part of the commercial building, like a major fire occurrence just before the completion date.

(2) erection insurance

Erection insurance policy is similarly arranged

as the construction insurance policy but satisfying an erection contract (like erection of oil tanks, boilers, generators or turbines, etc.). The cover commences on delivery of the machinery to the site of erection or installation, and terminates when erection, installation, testing and commissioning are completed.

A simple example will be the erection of machinery of a thermal power plant. The contract works will be the machinery involved, such as boilers, generators and turbines. The third party property, like adjacent buildings, may be damaged and the third persons, like walking-by pedestrians, may be injured, say due to a major explosion incident during the test-run of the machinery erected. Anticipated profits, such as the loss of income after the operation of the power plant, may be affected if delay is caused by the above-said explosion incident.

(3) contractors' plant and machinery insurance

Contractors' plant and machinery insurance policy is usually arranged by the contractors or the hirers under the terms of the hiring agreement to pay compensation mainly for loss of or damage to the plant or machinery utilized for construction or erection works (like bulldozers, cranes, compactors, pumps, excavators, etc.).

This insurance falls within the sub-classes (8) and (9) as illustrated above.

(4) machinery insurance

Machinery insurance policy is usually arranged by the owner of the machinery to supplement the cover afforded by a fire insurance policy on the machinery, which implies that the risk of breakdown (excluded from the cover of a fire insurance policy) is often the main exposure to hazards involved in the operation of the machinery. Cover may also be extended to include the loss of profits due to the distortion of the normal operation of the machinery in view of the breakdown of the machinery.

This type of insurance falls within the definition of sub-classes (9) and (16) as list above. A typical example will be a cover to the operational risk (mainly the risk of breakdown) of all the machinery of a power plant. Anticipated profits will be affected by the reduction of income due to the stoppage of operation or generation of electricity in case of the breakdown of the machinery.

(5) boiler & pressure vessel insurance

Boiler & pressure vessel insurance is specially arranged by the owner to cover any property operating under some degree of pressure, which is subject to

the risk of explosion or collapse and draws special attention. Usually one requirement of insurance is that the property shall have to be inspected constantly by authorized inspectors. Loss of anticipated profits can be covered when the third party liability exposure caused by the explosion or collapse can also be covered.

This type of insurance falls within the definition of sub-classes (9), (13) and (16) as listed above. Typical examples will be the boilers or pressure vessels within a power plant. The surrounding property or the third persons can be damaged or injured respectively due to an explosion incident. Similarly, loss of anticipated profits may be encountered in view of the stoppage of operation or generation of electricity due to the incident.

(6) deterioration of stock in cold storage insurance

Deterioration of stock in cold storage insurance is usually arranged by the owner to cover the damage to the contents of the cold stores as a direct result of breakdown of a refrigerating plant whilst in use.

This type of insurance falls within the definition of sub-class (9) as listed above. Typical examples are fruits, vegetables, fish, meat, medicine, chemical products, etc., which are subject to damage due to the rise or fall in temperature in view of the

breakdown of the refrigerating plant.

(7) electronic equipment insurance

Electronic equipment insurance is usually arranged by the owner or the hirer, who has a contractual responsibility to fulfil, to cover the following items:

- material damage to the installation
- financial costs incurred as a direct result of material damage to the installation

This type of insurance falls within the definition of sub-classes (9) and (16) as listed above. A typical example will be a computer installation of a bank. Financial costs incurred as a direct result of material damage to the computer installation due to fire, breakdown, etc. include the replacement costs of the lost or damaged data media by new material, the reproduction costs of the lost information, the additional expenditure incurred for the use of substitute computer equipment from other sources, etc..

(8) civil engineering completed risks insurance

Civil engineering completed risks insurance is usually arranged by the owner to cover loss of or damage to completed civil engineering works, which

have negligible fire exposure and high exposure to risks not covered under a fire insurance policy.

This type of insurance falls within the definition of sub-classes (8) and (9) as listed above. Typical examples are bridges, tunnels, highways, etc.. They can be subject to damage under the influence of storm, earthquake, landslides, etc., which are not the major perils to be covered under a fire insurance policy.

Reinsurance

Reinsurance is an independent branch of insurance. It covers the insurer against financial losses which he would suffer as a result of having to pay out on the insurance policies issued by him if he had not covered himself by reinsurance. The extent of cover in any particular case is determined by the contents of the reinsurance contract made between the insurer and the reinsurer, who provides the reinsurance.

Role of Reinsurance

As no insurer can have indefinite number of risks and there are in fact few risks that are truly similar or homogeneous, which make those risks less insurable than they should be. Hence, the fundamental objective of reinsurance is to help to reduce the degree to which claims costs of the insurance companies fluctuate as a

result of this imperfect application of "the law of large numbers". There are several purposes and advantages of reinsurance derived therefrom in more details as follows:

- to protect insurers against insolvency or financial strain from underwriting losses due to catastrophic events affecting one particular class of business or due to events leading to heavy accumulation of claims under different classes of business
- to stabilize the underwriting results of insurers due to small business portfolios, temporary fluctuation in basic probabilities and the change in background circumstances like inflation, crime rate, new methods of construction & processes, court awards, increase of claim consciousness, etc.
- to increase flexibility of insurers in size, volume and type of risk that they can underwrite
- to further achieve the spread of risk for insurers through the balance among different classes of business as well as among different geographical areas
- to finance insurers' operations by means of reinsurance commission allowed to them
- to assist insurers in underwriting, claims handling and other administrative and technical areas

Types of Reinsurance

In daily reinsurance practice, reinsurance can be classified as facultative reinsurance or treaty reinsurance.

Facultative means optional, the power to act according to a free choice. That is to say, when an underwriter of a reinsurer is offered a facultative reinsurance proposition by an insurer, the underwriter can accept or decline the proposition in accordance with his own underwriting judgment, which is usually considered on an individual basis. Facultative reinsurance is more appropriate to be used to handle cases with higher sum insured as well as higher complexity.

However, in a treaty reinsurance contract, the insurer undertakes to reinsure to a specified extent that all the risks described in the contract. It follows that the reinsurer, who for his part undertakes to accept these risks, cannot be asked for his assessment of those risks in every case. Usually, the contract terms would be negotiated every once a year according to the overall premium and loss experience for the past years. Treaty reinsurance is more appropriate to be used to handle cases with lower sum insured and lower complexity.

Our following study would concentrate on facultative reinsurance.

Facultative reinsurance

Arrangement

Basically, there are several ways of handling facultative reinsurance depending on the size of business and the degree of difficulty of the nature of business involved.

If the size is relatively small and the degree of difficulty is low (like construction of a 10-storey traditional residential building), the insurer would have provisionally agreed with the insured on insurance terms and subsequently submitted the details including the name and address of the insured, nature of risk, beginning and end of the insurance period, sum insured and insurance premium to the reinsurer for consideration, either direct or through reinsurance brokers. The reinsurer would then base on the information and decide to accept or decline the business offered (or even provide alternative proposal to the insurer). Upon this basis, the insurer would usually be more confident in placing the risk to reinsurers, otherwise, the following process would then be pursued.

However, if the size is huge and the degree of difficulty is high (like construction of a cross harbour tunnel), the insurer would usually approach the insured and collect the relevant information that the reinsurers would require. During this process, other technical services would also be offered by the reinsurer such as site inspection to assess the real exposure of the risk involved, design of the insurance policy suitable for the

risk involved, rating, etc.. Finally, the insurance or reinsurance terms based on the information collected from the insured would be provided by the reinsurer to the insurer for its onward submission to the insured. Upon the final acceptance of the insured on the terms submitted, the facultative reinsurance contract between the insurer and the reinsurer would also be concluded.

Advantages and disadvantages

The above six basic purposes or advantages of reinsurance is also applicable to facultative reinsurance.

However, there are several disadvantages noted for facultative reinsurance as below:

- 1) The insured as well as the insurer are required to disclose a lot of information in full details to the reinsurer, which may be very confidential in nature, particularly to the insured (like the full layout of the security system to be provided by the insured for the insurer's or reinsurer's assessment of the theft exposure).
- 2) The act of acceptance or the response time is delayed due to long process of underwriting work involved, which may be justified sometimes when the project is really significant.
- 3) Administrative cost would be heavy for all the parties concerned, particularly the reinsurer

- 4) As each piece of business is accepted on an individual basis, review of each and every file would be required for the renewal of the insurance policy upon expiry, if applicable, which would mean also heavy time cost.
- 5) The insurer tends to rely very much on the assistance of the reinsurer over the technical aspect and cannot resolve some of the underwriting issues though he is supposed to do so, particularly for cases with lower sum insured and lower complexity which should normally be handled under treaty reinsurance

Proportional facultative reinsurance

The facultative reinsurance is traditionally arranged under a proportional basis. That is to say, upon acceptance of a share of facultative reinsurance business offered, the reinsurer would have to pay the losses (that the insurer has to pay to the insured) according to the same proportion of the premium received (that the insurer collected from the insured).

Essentially, all the advantages as well as the disadvantages of facultative reinsurance are also applicable to the proportional facultative reinsurance.

Non-proportional facultative reinsurance

The non-proportional facultative reinsurance is not common to all parts of the world, it is only more actively used in the London market and the markets influenced

by the London market. The basis is that upon acceptance of a share of facultative reinsurance business offered, the reinsurer would have to pay for any one loss amount exceeding a certain level pre-determined between the insurer and the reinsurer according to the same proportion of premium received for that arrangement.

Special arrangement can further be made to structure the programme to include several layers designed to suit particular requirement for each individual case.

For example, a risk with sum insured HKD 100 million can be split into three layers with layering for claims from HKD 0 up to HKD 25 million as the Primary layer, for claims from HKD 25 million up to HKD 50 million as the first layer and for claims from HKD 50 million up to HKD 100 million as the second layer respectively. Three different premiums would be defined for these three layers respectively. Reinsurers could then participate for different shares on different layers, particularly the first and second layers.

There are some obvious advantages over the existing proportional facultative reinsurance and potential disadvantages brought about by this arrangement. The additional advantages are as follows:

- 1) The level of information required to submit by the insured is reduced as very detailed analysis on the exposure affecting smaller losses would no longer be

required by the reinsurer.

- 2) The act of acceptance or the response time is quicker in view of the fact that concentration is only on the exposure affecting larger losses following and hence less underwriting work is involved.
- 3) Administrative cost would be lowered, particularly to the reinsurer, in view of the fact that fewer cases should be put forward for facultative reinsurance as the insurer will retain more of the cases, particularly for cases with lower sum insured, which should fall under the primary layer. The reinsurer can then concentrate the time and effort over sizable and complex cases, which would generate more premium for the reinsurer.
- 4) Better use of facultative reinsurance capacity for relieving the strain of an insurer over catastrophic losses, which also goes in the same trend that more large losses are expected now than in the past.
- 5) The proportional facultative reinsurance business not be accepted by the reinsurer in view of under-pricing will have a way out through non-proportional facultative reinsurance as long as the insurer is willing to retain the primary layer.

However, the potential disadvantages can be as follows:

- 1) The insurer has to bear a larger portion of smaller losses particularly falling under the primary layer, which he may not agree to.
- 2) The right premiums for different layers are difficult to obtain in view of the lack of past statistical data as well as underwriting experience to back up the calculation.
- 3) The insurer is not experienced enough to handle this kind of programme particularly on the layering and placement of reinsurance. Assistance is usually sought from reinsurance brokers.

Nevertheless, the above potential disadvantages can easily be changed to advantages under the following situations:

- 1) The insurer can increase his own ability to select better quality business, which records with fewer losses in particular the smaller ones, through better underwriting techniques so that higher retention over the primary layer will bring more profits instead of losses to himself.
- 2) The reinsurer can give his support to the insurer in terms of providing more accurate pricing of each layer, through his better technical experience and worldwide market experience on the products. In this way, the insurer can also learn from the reinsurer and accumulate his own experience.

Engineering facultative reinsurance

Engineering facultative reinsurance means facultative reinsurance for engineering insurance business. As explained earlier, there are various insurance policies (at least 9 in total) classified as engineering insurance, facultative reinsurance will then be required for each type of engineering insurance policies concerned.

Obviously, the underwriting information required and the approach of the underwriting assessment used will definitely vary from one type of engineering insurance policy to another.

Present Problems over Facultative Reinsurance Business

Underwriting results of engineering insurance business for the insurers in Hong Kong, have not been very satisfactory for the past few years. Similarly, the underwriting results of the reinsurers, which have been very active in this market accepting proportional facultative engineering reinsurance business from the insurers (i.e. the predominant form of facultative reinsurance in the market) also deteriorate a lot.

The reasons contributed to the negative underwriting results can be summarized as follows:

1) Competitive terms

In view of keen market competition, the under-

writers of the insurers tend to offer very competitive terms particularly on the coverage given being very wide through granting a lot of extensions, premium received being very low and excess (i.e. the minimum monetary amount that the insured has to bear for each and every loss) being also very low.

The overall consequence is the lack of adequate funds to pay any future losses.

2) Inadequate underwriting knowledge of the underwriters

Engineering insurance tends to be very technical to general insurance practitioners particularly when more complex construction and erection works to be insured under Construction Insurance and Erection Insurance respectively as well as more complex machinery and electronic equipment to be covered under Machinery Insurance and Electronic Equipment Insurance respectively. Majority of underwriters of the insurers are not specially trained in those relevant technical fields although some underwriters are indeed trained as civil, electrical or mechanical engineers by background. Assessment of exposure is relatively restricted by the prior experience of the underwriters involved.

The overall consequence is that proper terms may not be possibly imposed to protect the insurers as well as the reinsurers as the exposure may not be

exactly determined and examined, even though with the help from the reinsurers.

3) Claim-consciousness of the insured

The insureds become very claim-conscious in view of their improved awareness on the engineering risk exposure and their understanding of the insurance policies. They would make the full recovery as far as possible under the allowance of the terms laid down in the policies, which would lead to the situation that more claims would have to be handled than before.

The overall consequence is that rating guidelines based on past experience and statistics would no longer be suitable and always show inadequate premium to be charged in view of the above tendency on increase of frequency of claims.

4) Increase of physical and moral hazards

As the technology improves from time to time, more advanced construction and erection methods are being employed by the contractors to construct more difficult structures and to erect more sophisticated machinery respectively. Similarly, more complex and advanced machinery of higher values are invented to assist the contractors to perform the works. The rapid increase in complexity and values would certainly affect the chance of having a catastrophic loss, which

can seriously affect the pattern of anticipated losses in terms of both the frequency and the magnitude, and hence the underwriting results. On the other hand, moral hazard is also increased particularly in the areas of construction or erection contracts where the contractors have to live on a very tight margin of profits, which leads to the possible situation that the contractors would seek all possible ways to get indemnification from the insurers. This can further deteriorate the underwriting results.

The overall consequence is that more large or small claims are noted than before.

The above trends tend to continue although both the insurers and the reinsurers try to rectify the situation through corresponding amendments over the terms. Nevertheless, the effect of competition, particular those market leaders intend to maintain their leading position, tends to affect the pace of this recovery process.

A Possible Solution To Solve The Present Problems

In order to turn the deficit situation of both the insurers and the reinsurers back to the profitable situation, a new product "non-proportional engineering facultative reinsurance" with the above potential benefits over the existing proportional engineering facultative reinsurance can be put forward to the market, particular-

ly to the target market we have identified - large locally incorporated insurance companies in Hong Kong, which share a substantial proportion of premium written for engineering insurance business in Hong Kong.

Obviously, there are various needs we can observe in large locally incorporated insurance companies which are not satisfied as summarized below (with further analysis available in Chapter II) leading to some of the present problems:

- 1) Large incorporated insurance companies are trying to identify better quality business and to improve their risk control capability (on both physical and moral hazards), which may be achieved through the incorporation of a special team by employing in-house engineers and specialists to handle the business while they are more willing and can afford to do so.
- 2) Large locally incorporated insurance companies are trying to earn profits through achieving positive technical results (i.e. insurance premium received is more than claims paid) by retaining more insurance premium under their own net account instead of through receiving high commissions from the reinsurers by passing the risks to the reinsurers.
- 3) Large locally incorporated insurance companies intend to remain their competitiveness in the market, which can be done by reducing their cost through acquiring cheaper reinsurance protection on those risks they

really need protection (i.e. peak losses instead of small losses).

- 4) Large locally incorporated insurance companies intend to further develop their existing portfolio through their large sales network if they can find the chance of achieving eventual profits.
- 5) As large locally incorporated insurance companies intend to concentrate on larger and complex accounts, in which they can really show their strength, and to efficiently utilize the available reinsurance capacity in the market.

On the other hand, there are various reasons as listed below for picking up this new product, being suitably provided by a Hypothetical Reinsurance Company with further analysis on that company available in Chapter III, which can really satisfy the above mentioned needs after also considering the competitive environment as explained in detail in Chapter IV:

- 1) The Hypothetical Reinsurance Company has a local resident engineer in the office who can obviously provide all sorts of technical services including underwriting, claims handling, risk management and assessment particularly on complicated engineering risks, pricing, training on aspects relating to engineering, insurance and new non-proportional reinsurance product, etc. to satisfy the needs of the large

locally incorporated insurance companies to identify better quality business, to acquire risk control techniques or even to set up a special team to handle the business.

- 2) The Hypothetical Reinsurance Company can provide the right capacity to the large locally incorporated insurance companies and at the same time can also satisfy the need of the large locally incorporated insurance company to retain more insurance premium within their own account through their retention of the primary layer of the non-proportional engineering facultative reinsurance arrangement.
- 3) Through the offer of the new non-proportional engineering facultative reinsurance arrangement, the Hypothetical Reinsurance Company can satisfy the need of the large locally incorporated insurance companies in further developing the business at a more competitive position through giving a relatively cheaper reinsurance protection for the higher layers while the insurance companies can charge lower premium for the primary layer if they wish to do so. The concentration of the sales effort on the limited potential market or the niche market can further strengthen local connection of the Hypothetical Reinsurance Company to several companies. Continuous connection with the large locally incorporated insurance companies, which share a substantial proportion of market business, can

maintain the presence of Hypothetical Reinsurance Company in the market and assist him in collecting market experience and information in order to allow a better pricing of the reinsurance in the long run, which again will improve the overall competitive position of those insurance companies.

- 4) The Hypothetical Reinsurance Company can concentrate his effort to provide capacity to the large locally incorporated insurance companies for large and complex accounts while the non-proportional engineering facultative reinsurance arrangement can allow the Hypothetical Reinsurance Company to more effectively use the time and the capacity.

In conclusion, the unsatisfied needs of the large locally incorporated insurance companies can well be satisfied by the new non-proportional engineering facultative reinsurance product. This is the potential niche market that attracts the attention of the Hypothetical Reinsurance Company to although severe resultant competition may be anticipated from direct competitors.

Objective of This Project

The objective of this project is to further work upon the above findings to achieve the followings:

- to develop the essential components about the launch of the new product in Hong Kong, which is recorded in Chapter V

- to carry out questionnaire survey on the essential components about the launch of the new product so identified over some selected customers from the identified niche market and to evaluate the findings, which is recorded in Chapter VI
- to develop the final marketing plan in terms of product, pricing, promotion, sales force and distribution to assist the launch of the new product in Hong Kong, which is recorded in Chapter VII
- to draw conclusions from the above exercise, which is recorded in Chapter VIII

The eventual goal of this project is to identify a marketing plan for the launch of the new product to supplement the existing proportional engineering facultative reinsurance arrangement and to enable the Hypothetical Reinsurance Company to maintain a profitable portfolio for the next five years in Hong Kong.

CHAPTER II

MARKET OPPORTUNITIES AND POTENTIAL PROFILE OF INSURERS ON NON-PROPORTIONAL FACULTATIVE REINSURANCE FOR ENGINEERING INSURANCE BUSINESS

Primary Demand

The primary demand for engineering facultative reinsurance mainly comes from insurers as those six basic purposes or advantages of facultative reinsurance explained before can satisfy the basic needs of the insurers. This demand would generally induce the insurers to look for engineering facultative reinsurance available in the market, which is mainly in the form of proportional basis.

However, the particular primary demand for non-proportional engineering facultative reinsurance is induced by the following additional factors expanded in more details though also indicated before:

- to retain as much insurance premium as possible under the insurer's net account (through retaining the primary layer of a non-proportional facultative reinsurance arrangement) when the insurer intends to further

develop the engineering insurance business and has the technical know-how to handle the business through injection of more resources and expertise into the company (particularly to select better quality business), and at the same time, it does not have an immediate problem over the solvency margin

- to retain more profits for the insurer when the general result of the business is considered to be profitable in the long run
- to acquire more inexpensive facultative reinsurance protection so as to maintain the insurer's competitiveness in the market
- to rely on the reinsurers to provide the pricing of higher layers of the non-proportional facultative reinsurance arrangement
- to use more effectively the capacity and the technical support from the reinsurers, in terms of time and administrative cost involved

Buyer-identification

Usually the buyers of engineering facultative reinsurance would be of the following characteristics:

- mainly locally based (i.e. they do not have global reinsurance programme arrangement, which is usually in the treaty form, available mainly to foreign incorporated insurance companies)

- limited experience and expertise along this line of business
- book of business concentrated to one area (e.g. a locally incorporated insurance company)
- management of the company more prone to the concept of reinsurance (i.e. the spread of risk) and willing to input more resources to develop this line of business

For those companies more attracted to seek non-proportional engineering facultative reinsurance instead of proportional engineering facultative reinsurance consist the following additional characteristics:

- to have a strong company's willingness to spend resources on the engineering insurance business (e.g. the set-up of an engineering team or the recruitment of engineers or specialists to take care of business along this line of business, etc.) in view of a company's belief that the results will then be significantly improved
- to expect a long term profitability over this line of business through imposition of proper terms and conditions and to further develop the existing business portfolio in a competitive position as far as possible
- to have a belief that profits should eventually be earned through higher retention of insurance premium

instead of through receipt of higher commission from the reinsurers

Willingness and Ability to Buy

The insurers' willingness to buy reinsurance depends heavily on:

- whether the reinsurers can provide the adequate technical support as well as capacity required
- whether the reinsurers are financially sound and the response time is short

In the end, the price is the most important factor that determines whether the insurer can afford to buy the reinsurance.

To impress the insurer to seek non-proportional engineering facultative reinsurance instead of the traditional one, apart from the above factors, the following three messages must have got the fundamental effects:

- the insurer is convinced of his own expertise to handle the business and to bring the business to profitability
- the insurer can retain more insurance premium as well as possible profits in the end through the new reinsurance arrangement and even expand the business portfolio
- the price of reinsurance is much lower

Market Segmentation

Sales Force Allocation to Accounts

Volume

In general, large insurers usually with more resources will intend to write larger accounts, which attract more facultative reinsurance capacity. However, the competitiveness of those accounts is usually more severe and the resultant price is cheaper. But the reinsurance premium involved is relatively significant, which is more than enough to cover the basic administrative cost involved on the eventual risk carriers (including accounting cost, computer cost, etc.) though the time consumed per one large account is usually longer than that consumed per one small account.

On the other hand, small insurers will aim at smaller accounts, which attract little facultative capacity. The competitiveness of those accounts is usually less severe and the price is relatively better. However, the reinsurance premium involved is small and less economical to be written though the time consumed per one small account is short.

Time cost involved should not be neglected when we consider non-proportional facultative reinsurance arrangement as the analysis can be more involved to arrive at a 'correct' reinsurance premium depending on the 'layers' under investigation though the number of possi-

ble perils considered will be smaller (i.e. only the perils which can cause losses falling within or higher than the 'layer' under consideration will be looked at) particularly under a situation of inadequate information available. Minimum reinsurance premium to cover the basic administrative cost can be higher for non-proportional facultative reinsurance than proportional facultative reinsurance. On the other hand, the reinsurance premium involved must also be smaller as the original reinsurance premium on a proportional basis will have to be divided into several 'layers' based on a non-proportional basis. This will definitely push reinsurers to look at more sizable accounts in terms of the issue on administrative costs.

Quality

In general, the in-house group business (i.e. both the insurer and the construction company belonging to the same group) is of a much higher quality in terms of better loss prevention and control able to be carried out. Better communication channels can be established in case of any problems. Rectification works can be agreed in view of the close relationship.

Through the introduction of non-proportional facultative reinsurance, the reinsurers can persuade the insurer to increase the excesses as laid down under the original insurance policy to a more reasonable level, which will reduce the exposure of the insurer in absorb-

ing frequent small losses hitting the underlying or the primary layer under the non-proportional facultative reinsurance arrangement. As a result of it, the chance of profitability of the accounts will definitely increase.

Product Design and Communications Appeals

The usual benefits and attributes sought and product usage for engineering proportional facultative reinsurance are as follows:

- for capacity on sizable or difficult accounts, which are most favoured by those smaller insurers
- for some sorts of protection, like financial stability, claim ratio stability, relief from solvency margin and accumulation of claims, etc., which are most favoured by those smaller insurers with a less balanced portfolio when medium to giant risk is considered and by those larger insurers when only giant risk is considered
- for technical support in terms of risk assessment and management, claims settlement and pricing, which are most favoured by those smaller insurers when medium to giant risk is considered and by those larger insurers when only giant risk is considered
- for combinations of above reasons

There are three additional attributes particularly

important if the reinsurance is arranged on a non-proportional basis as follows:

- for retaining more insurance premium as well as profits under the insurer's own net account when the solvency margin is not an immediate problem to the company
- for building up experience and technical premium reserve (for paying future large losses) for business along this line, which is particularly important for future development
- for maintaining the insurer's competitiveness in the market through obtaining cheaper facultative reinsurance protection

Communications Targets

Reinsurance departments

Engineering facultative reinsurance can be arranged through the reinsurance department of an insurer. The reinsurance manager will usually be the person-in-charge to decide where to place the business to, though some guidance should have been laid down by the general management on the acceptability of the security of the reinsurers in general.

Casualty or engineering departments

The business is usually produced by the casualty or engineering departments, with their connections to bro-

kers or agents. They are the front line persons to screen the business in terms of their size and quality. The casualty or engineering manager is the person-in-charge to decide to take up the business or not. Engineering facultative reinsurance can also be arranged through these departments.

Insurance Companies in Hong Kong

As at December 1991, there were a total of 240 companies authorized to transact insurance business in Hong Kong. Out of this number, 113 were locally incorporated while the remaining 127 were incorporated in foreign countries, mainly in the United Kingdom for 32 and in the U.S.A. for 22 respectively. Moreover, those 113 companies had represented 96 pure general or non-life insurance companies, 7 pure life insurance companies and 10 composite insurance companies.

Under our special interest in this project, the top 20 locally incorporated insurance companies (including pure general insurance companies and composite insurance companies) are ranked by their gross insurance premiums written on general insurance business in 19xx (Table 1). The insurance business written include business from Hong Kong as well as from overseas. Out of the 20 locally incorporated insurance companies, 75% are pure general insurance companies and the remaining 25% are composite insurance companies.

TABLE 1

RANKING OF THE TOP 20 LOCALLY INCORPORATED INSURANCE COMPANIES (INCLUDING PURE GENERAL INSURANCE COMPANIES AND COMPOSITE INSURANCE COMPANIES) BY THEIR TOTAL GROSS INSURANCE PREMIUMS WRITTEN ON THE GENERAL INSURANCE BUSINESS IN 19XX

RANKING	NAME	GROSS INSURANCE PREMIUMS WRITTEN (HKD IN MILLION)	TYPE
1	AA	627	GENERAL
2	BB	623	GENERAL
3	CC	370	GENERAL
4	DD	316	COMPOSITE
5	EE	297	GENERAL
6	FF	289	GENERAL
7	GG	259	GENERAL
8	HH	256	COMPOSITE
9	II	246	COMPOSITE
10	JJ	243	GENERAL
11	KK	117	GENERAL
12	LL	108	COMPOSITE
13	MM	87	COMPOSITE
14	NN	85	GENERAL
15	OO	80	GENERAL
16	PP	77	GENERAL
17	QQ	73	GENERAL
18	RR	64	GENERAL
19	SS	63	GENERAL
20	TT	58	GENERAL

Unfortunately, there is no formal statistics available in the market showing engineering insurance premium written by each insurance company since engineering insurance business is usually interpreted as part of accident line of business consolidated in the annual report of each insurance company or as part of property damage line of business recorded in the insurance report compiled by the Hong Kong Insurance Authority. Nevertheless, approximate figures were obtained through various sources including private consultation with each insurance company concerned. Hence, gross insurance premium written on property damage insurance business (including the property damage section of most of the types of engineering insurance business, according to the classification by the Insurance Companies Ordinance) in various countries (including Hong Kong) and estimated gross insurance premium written on the insurance business in Hong Kong, by those 20 largest locally incorporated insurance companies (including pure general insurance companies and composite insurance companies) in 19xx are similarly tabulated (Table 2). 32% of the whole market gross insurance premium of HKD 200 million on the engineering insurance business in Hong Kong are written by those 20 largest locally incorporated insurance companies.

The remaining 68% of the whole market gross insurance premium on the engineering insurance business are shared by other locally incorporated insurance companies

TABLE 2

GROSS INSURANCE PREMIUMS WRITTEN ON THE PROPERTY DAMAGE INSURANCE BUSINESS (INCLUDING ENGINEERING INSURANCE BUSINESS, ACCORDING TO THE CLASSIFICATION BY THE INSURANCE COMPANIES ORDINANCE) IN VARIOUS COUNTRIES (INCLUDING HONG KONG) AND ESTIMATED GROSS INSURANCE PREMIUMS WRITTEN ON THE ENGINEERING INSURANCE BUSINESS IN HONG KONG, BY THE TOP 20 LOCALLY INCORPORATED INSURANCE COMPANIES (INCLUDING PURE GENERAL INSURANCE COMPANIES AND COMPOSITE INSURANCE COMPANIES) IN 19XX

NAME	GROSS INSURANCE PREMIUMS WRITTEN ON THE PROPERTY DAMAGE INSURANCE BUSINESS IN VAR- IOUS COUNTRIES IN 19XX (HKD IN MILLION)	GROSS INSURANCE PREMIUMS WRITTEN ON THE ENGINEER- ING INSURANCE BUSINESS IN HONG KONG IN 19XX (HKD IN MILLION)	SHARE OF WHOLE MARKET GROSS INSURANCE PRE- MIUMS ON THE ENGINEERING INSURANCE BUS- INESS IN HONG KONG (IN %)
AA	284	10	5
BB	230	15	7.5
CC	143	2	1
DD	118	3	1.5
EE	7	0	0
FF	2	0	0
GG	71	15	7.5
HH	14	3	1.5
II	102	5	2.5
JJ	65	3	1.5
KK	1	0	0
LL	0	0	0
MM	25	1	0.5
NN	8	1	0.5
OO	30	1	0.5
PP	42	1	0.5
QQ	31	3	1.5
RR	1	0	0
SS	24	1	0.5
TT	0	0	0
TOTAL		64	32

(estimated at around 13%) and foreign incorporated insurance companies (estimated at around 55%, where statistic is not available for each company in the market as the performance of the company's operation in Hong Kong is consolidated in the annual report of the parent company).

Moreover, it is also estimated that out of the whole market gross insurance premium, roughly 50% are ceded as facultative reinsurance premium (which are mainly on a proportional basis) to various reinsurers. The major users of the facultative reinsurance market are locally incorporated insurance companies while foreign incorporated insurance companies usually have more automatic facilities provided by their parent companies and do not require a great deal of facultative reinsurance support.

Our attention is particularly drawn to locally incorporated insurance companies for the following study.

Insurance Companies Dealing with Engineering Insurance Business

From the figures shown in the Table 2, attention as well as detailed analysis have been particularly paid to three companies of the list AA, BB and GG respectively which have already generated an accumulated figure of around 20% of the whole market gross insurance premium on the engineering insurance business.

GG

GG has been involved in engineering insurance business in Hong Kong for over 20 years but the results for the recent few years are not satisfactory.

Company philosophy

GG has an automatic facility provided by their engineering treaties up to a certain limit (i.e. they can issue insurance policies with terms quoted by themselves to the insured provided that the total contract value of the engineering project concerned or the total sum insured of other engineering risks concerned is less than the aggregate limit specified by the relevant engineering treaties). For difficult cases or cases with sum insured greater than the above mentioned limit, they would intend to request facultative reinsurance support from reinsurers, particularly the professional reinsurance companies who are specialized to offer reinsurance services (with a more detailed analysis available in Chapter III). The main reasons, in addition to those primary reasons identified before, are listed as follows:

- to get in touch with the world-wide development in engineering insurance as the professional reinsurance companies have world-wide exposure or connections (apart from the local Hong Kong experience) through their own overseas operations or their other overseas offices
- to rely on all aspects of engineering support from professional reinsurance companies as GG has no resi-

dent engineer in the office

- to reduce the exposure on their automatic facility as the loss experience on engineering business can be very unsteady if proper terms and conditions are not applied
- to get a quicker and stronger reinsurance support from those professional reinsurance companies who have local representation

Sources of engineering insurance business

GG's usual sources of business are as follows:

- via 20 professional direct brokers (60%)
- via 40 agents (30%)
- via 5 in-producers or salesman (5%)
- via direct contacts with few corporate clients (5%)

In general the business from brokers are more demanding than the business from other sources as the brokers have the obligation to seek the best cover and terms for the insured.

Sources of facultative reinsurance support

In view of GG's philosophy, they intend to work more closely with professional reinsurance companies to establish a long-term relationship. Hence, GG's usual sources of support are as follows:

- professional reinsurance companies (95%)
- underwriting agencies/reinsurance brokers/insurance companies (5%)

The present facultative reinsurance is basically placed on a proportional basis.

Internal set-up

A separate engineering team is organized to deal with all aspects concerning about the production and underwriting of engineering insurance business. There are several junior clerks headed by an executive in this team. Each clerk has to deal with the brokers, the agents, their in-house salesman or direct clients on negotiation of insurance terms on several specialized sub-divided lines under engineering insurance business and at the same time to contact the reinsurers, particularly professional reinsurance companies, for advice or support. All the business activities have to be reported to the executive. Then, the executive has to report to the manager, who is also in charge of other lines of business, for business production in general.

Claims are handled by a different centralized department. As mentioned before, they have no resident engineer in the office, which will from time to time affect the quality of business accepted as the real exposure of the risk assumed is not correctly assessed if

without the help from professional reinsurance companies.

Decision-making process

The management has laid down the list of security (i.e. reinsurers) in accordance with their evaluation of the financial, technical and historical background of each company that GG can use. However, out of this list, the manager, the executive and all the clerks would have agreed to work more with some companies than the others. The situation would also be more controlled under the hands of the clerks who directly handle the business, who can concentrate to work with some companies they prefer. The selection would heavily depend on the following factors:

- personal relationship
- all sorts of technical support provided
- flexibility in terms of accommodating substandard business in certain occasions

The executive would have some influence over the clerks if the complexity and size of the account are significant. Usually for the day-to-day operations, the executive is the decision maker.

The manager would have some influence over the executive on an overall basis if the production or claims figures deviate from the normal expected trend.

Present potential problems and needs

They have suffered underwriting losses on engineering insurance business for the past few years. Their treaty capacity has been reduced, which drives them to seek more facultative reinsurance support, particularly for large cases.

Better quality business is very important to rectify the present situation while improvement over terms is not very possible under the present market conditions. Strengthening of the engineering team particularly in terms of technical knowledge (through recent restructuring to delegate the responsibility of sub-divided lines under engineering insurance to specialized individual person) to improve the quality of business to be accepted as well as purchasing of a more flexible facultative reinsurance product particular in terms of the price to acquire at the same time a competitive advantage over the competitors are considered as their present needs.

Further development of business is then possible, particularly for large cases which are identified previously as more administratively effective for both large locally incorporated insurance companies and professional reinsurance companies.

Eventual goal is to turn the present underwriting deficit position back to an underwriting profit position through higher retention of insurance premium over a long term basis, which they also firmly believe in.

Non-proportional facultative reinsurance seems to be one of the possible alternatives to satisfy their present needs.

BB

BB has also been involved in engineering insurance business in Hong Kong for over 20 years. The overall results are very marginal.

Company philosophy

In view of the company background closely related to a giant group, they have to comply with the group's strategy in the area, more as a servicing company to their in-group companies in Hong Kong, and to provide very competitive insurance terms.

Like other insurance companies, BB has also an automatic treaty facility to accept business. They intend to use more of the facility in view of the competitive terms of their business, particularly the in-group business.

On the other hand, they are also quite aggressive to the market business in order to maintain their present market position. They also tend to use professional reinsurance companies as facultative reinsurance supporters in view of the reasons similar to those of GG. They have one special additional reason as follows:

- to request special acceptances from professional reinsurance companies on some of their in-group business, which are much more competitive than the market terms due to some special commercial reasons

Sources of engineering insurance business

BB's usual sources of business are as follows:

- via 20 professional brokers (30%)
- via few agents (5%)
- via more than 20 in-house salesman (20%)
- via in-group referral business (25%)
- via direct clients (20%)

More than half of the business obtained within the company are not very subject to market competition (the last three items listed above) although they have to make a lot of compromises from time to time. They still compete for the market business through their connections with brokers.

Sources of facultative reinsurance support

BB also tends to develop direct business relationship with professional reinsurance companies particularly as mentioned before. Their usual sources of facultative reinsurance support are as follows:

- professional reinsurance companies (90%)

- underwriting agencies/reinsurance brokers/insurance companies (10%)

The present facultative reinsurance is placed on a proportional basis.

Internal set-up

Production and underwriting of business are separated. There is a marketing department controlling the business production. The marketing department in itself has no underwriters to screen the business in terms of its quality but they have a limited authority to accept small business on an accommodation basis. However, this kind of business usually does not need any facultative reinsurance support and is totally absorbed by the automatic facility. For larger cases, referral to a separate underwriting department is required.

As engineering insurance business is considered as part of the casualty business, the underwriting issue is performed under the casualty department. In general, there are several clerks allocated to serve this line of business but they only perform the administrative work. One executive supervising those clerks takes control over the quotation and facultative reinsurance placement of the engineering insurance business in view of the possible technical knowledge involved, who has to report to the manager of the casualty department.

Claims will also be handled by the same casualty department. In the meantime, BB has no resident engineer in the office.

Decision-making process

Similarly, the management has also laid down a list of security that they can use. However, the manager of the casualty department controls the decision for final facultative reinsurance placement while the executive can only influence to a small extent. The clerks have no influence at all on the above.

Present potential problems and needs

The technical result on engineering insurance business of the company has been very marginal for the past few years. Although their treaty capacity has not been reduced, they still encounter from time to time business with very competitive terms, which drives them to seek more facultative reinsurance support (as far as possible though sometimes not possible) to reduce the potential losses to their automatic treaty facility that may not be easily renewed in future. Risk control, imposition of proper insurance terms (particular for the in-house business) and the identification of better quality of business are considered to be very important.

Although an engineering team has not been physically set up, the executive within the casualty department is actually responsible for the engineering insurance busi-

ness. Further reinforcement on technical knowledge to improve the quality of business to be accepted and to impose proper insurance terms as well as purchasing of a more flexible facultative reinsurance product particularly in terms of the price, instead of the continuous practice of accommodation in the past, to acquire at the same time a competitive advantage over the competitors are considered as their present needs.

Further development of business is then possible, particularly for large cases which are identified previously as more administratively effective for both large locally incorporated insurance companies and professional reinsurance companies.

Eventual goal is to turn the present underwriting deficit position back to an underwriting profit position through higher retention of insurance premium over a long term basis, which they also firmly believe in.

Non-proportional facultative reinsurance also seems to be one of the possible alternatives to satisfy their present needs.

AA

AA has also been in the market for over 20 years. The overall results are very marginal.

Company philosophy

Similarly, as the company background is also closely

related to a giant group, which has brought a lot of business to the company, particularly from the overseas countries. Their company philosophy of writing business is still considered as conservative as far as the business in Hong Kong is concerned, which shares only around 13% of the total gross insurance premium written.

AA has an automatic treaty facility up to a certain limit and tends to underwrite themselves for risks falling within this limit as they have a very experienced underwriter although he is not an engineer by background. For risks in excess of their automatic facility, they will tend to ask for facultative reinsurance support from the market, particularly from professional reinsurance companies. Their reasons to seek professional reinsurance companies for support are similar to those of GG.

Sources of engineering insurance business

AA's usual sources of business are as follows:

- via 20 professional direct brokers (50%)
- via 20 active agents (40%)
- via direct clients (20%)

Price competition is still considered as a very important factor for them to secure the business, particularly for the business from brokers.

Sources of facultative reinsurance support

AA also tends to work closely with professional reinsurance companies. Their usual sources of facultative reinsurance support are as follows:

- professional reinsurance companies (95%)
- underwriting agencies/reinsurance brokers/insurance companies (5%)

The present facultative reinsurance is placed on a proportional basis.

Internal set-up

As BB, they have a marketing department responsible for business production. Although technically there is no separate engineering or casualty department formed to handle the underwriting of engineering insurance business, there is one engineering underwriter internally as mentioned before recognized as the person to handle the business, particularly those requiring facultative reinsurance support. Normal clerical support is available to perform the administrative work.

Claims will be handled by the another separate department. In the meantime, they have no resident engineer in the office to take care of the business.

Decision-making process

Similarly as the other insurance companies, the

management has also laid down a list of security that they can use. However, the decision is usually made by the engineering underwriter where to approach for quotations and facultative reinsurance support. Other persons' influence is minimal.

Present potential problems and needs

Similarly, the technical result on engineering insurance business of the company has been very marginal for the past few years. As they are very conservative in writing business, which drives them to seek more facultative reinsurance support in order to obtain the correct technical terms and conditions, particularly in the present market conditions. Better quality of business is very important.

Although an engineering team has not been physically set up, the engineering underwriter within the company is actually responsible for the engineering insurance business. Further reinforcement on technical knowledge to improve the quality of business to be accepted as well as purchasing of a more flexible facultative reinsurance product particularly in terms of the price to acquire at the same time a competitive advantage over the competitors are also considered as their present needs.

Further development of business is then possible, particularly for large cases which are identified previously as more administratively effective for both large locally incorporated insurance companies and professional

reinsurance companies.

Eventual goal is to turn the present underwriting deficit position back to an underwriting profit position through higher retention of insurance premium over a long term basis, which they also firmly believe in.

Non-proportional facultative reinsurance also seems to be one of the possible alternatives to satisfy their present needs.

Summary

The primary demand for non-proportional engineering facultative reinsurance is carefully analyzed, which would include the general demand as well as the specific demand. The specific demand (including the wish to retain more insurance premium through stronger technical know-how, to target for more profits in the long run, to acquire more inexpensive reinsurance protection and to obtain reinsurer's capacity and technical support on a more cost effective way) is generally not satisfied by the traditional proportional engineering facultative reinsurance. The analysis helps to identify those insurers with distinct characteristics in terms of their general needs and their willingness & ability to buy the new form of facultative reinsurance. Further analysis over the market segmentation of the insurers is achieved through identifying their specific characteristics in general over the sales-force allocation to accounts (in

terms of both the quantity and the quality of accounts), product design & communications appeals and communication targets for the new form of facultative reinsurance.

Coupling the above information with the actual statistics available over the insurers in the market, study is concentrated to locally incorporated insurance companies, particularly three large companies, which have already generated an accumulated figure of around 20% of the whole market gross insurance premium on the engineering insurance business. Careful study of the three large locally incorporated insurance companies over the areas of their company philosophy, their sources of engineering insurance business, their sources of facultative reinsurance support, their internal set-up, their decision-making process and their present potential problems and needs has shown distinct characteristics of some unsatisfied needs. These unsatisfied needs are essentially very similar to those needs identified as the specific demand for non-proportional engineering facultative reinsurance earlier.

In conclusion, non-proportional facultative reinsurance can be regarded as one alternative to satisfy the present needs of the three large locally incorporated insurance companies, which we have made our study on in particular.

CHAPTER III

THE HYPOTHETICAL REINSURANCE COMPANY

Types of Reinsurance Sellers

Essentially, reinsurance sellers can be classified under five broad categories. They are professional reinsurance companies, Lloyd's syndicates, direct insurance companies, underwriting agencies and state reinsurance corporations respectively selling reinsurance in a market to a different extent.

Professional reinsurance companies exert a considerable effect over the reinsurance market, which we intend to concentrate on in our following study.

Professional Reinsurance Companies

Many professional reinsurance companies are multinational companies operating through branch networks or subsidiary companies throughout the world. Others are located in only one market but they may be offered business by local as well as overseas insurance companies or brokers.

They usually have the following special features:

- strong financial background in terms of assets and reserves
- capability to provide technical advice on underwriting, claims handling, risk management and assessment, accounting, etc. to clients
- capability to provide training facilities to clients
- flexibility in terms of reinsurance coverage as well as limits to be provided to clients

The usual business transaction within a reinsurance company can be classified into two types, namely facultative reinsurance and treaty reinsurance respectively. The distinction between the two types of reinsurance is explained earlier.

In the following study, concentration is put on a typical professional reinsurance company offering facultative reinsurance for engineering insurance business.

Typical Set Up of a Professional Reinsurance Company
Offering Facultative Reinsurance for
Engineering Insurance Business

Usually the head office is located in the country of origin of the reinsurance company. Representative, branch or subsidiary offices (if any) will be operating at the overseas countries. Regional offices will also be established to coordinate activities in several countries

sharing common features.

Depending on the nature of the overseas offices, different degree of delegation of authority will be expected. There are several main areas worth considering in more details.

Marketing Activities

Marketing plans are usually formulated in the overseas offices in accordance with the company mission as well as the market conditions and endorsed by the head office. The work in the head office is usually delegated to market departments. Moreover, when the network of offices is so large that the market department in the head office is incapable to supervise effectively, a regional office will be established within a particular region of overseas operations. Some of the head office responsibilities will be transferred to this office, which make the overall overseas operations more efficiently handled, particularly when time is of particular essence. Another very important advantage is to make allowance for a better regional strategy to be formulated locally, particularly when several nearby countries are sharing similar economic environment and business opportunities in a region.

Usually each overseas office is responsible for at least one or more countries. Executives within the overseas office will frequently travel to each country to

carry out the necessary marketing work as laid down in the marketing plan. Some marketing programmes will be coordinated jointly with the regional office as well as with the head office.

General marketing activities of a reinsurance company usually include the following:

- to give lectures or seminars to some specific companies, to the market or to the region as a whole
- to give scholarship awards to some specific companies, to the market or to the region as a whole
- to pay regular company visits
- to distribute general publications including annual company report, technical guidebooks, company magazines or newsletter, etc. to clients
- to distribute company gifts to clients
- to provide training programmes including management training programmes organized in overseas, regional or head offices to named individuals in some specific companies

Underwriting Activities

In respect of underwriting activities, the technical department on engineering insurance in the head office is the responsible center for technical support along this particular product line. Their tasks include the follow-

ing:

- preparation of technical guidelines, provision of technical support/backup and delegation of appropriate authority on different products along this particular product line for the underwriters within the company
- conducting of global training programmes along this particular product line
- new product development or product modification
- setting up of global underwriting strategy
- technical analysis of the company portfolio leading to the refinement of the underwriting strategy and product development

The above responsibilities may be shared in one way or another by the underwriters in the regional office. The obvious advantage of having a regional office will be a closer and quicker response to the need of a region.

Front line underwriters will be those facing clients on a daily basis. The following additional services will be provided:

- to provide tailor-made lectures or seminars to clients
- to provide technical support on underwriting, claims handling, risk management and assessment through risk inspection, etc. to clients

Underwriting authority will be delegated to the different level of underwriters working in different offices. It is authorization given to underwriters to write or accept business up to a certain limit. In case of requirement of high limits as well as special terms and coverage, technical support can be obtained from the regional office or further from the head office.

Other Activities

Other activities include the accounting and general administration work. Accounting work consists of reinsurance premium collection and reinsurance claims payment while general administration work consists of filing of proper underwriting files for each facultative case accepted. All these activities are performed in the overseas office. Proper records will be updated in the regional office as well as the head office through a computer network or a manual system.

General Operation of Facultative Reinsurance for Engineering Insurance Business of the Hypothetical Reinsurance Company

The Hypothetical Reinsurance Company under our study consists of the following characteristics:

- the head office located outside of Hong Kong and having operated over a very long time with a very strong

historical and financial background

- an overseas branch office operating in Hong Kong for less than 5 years
- a regional office also operating in Hong Kong for less than 5 years
- before the establishment of the branch office and the regional office in Hong Kong, the marketing work being essentially carried out by the branch office located outside of Hong Kong
- a team consisting of a marketing/underwriting executive employed under the regional office as well as a marketing/underwriting executive, a local engineer and one supporting clerical staff being employed under the branch office to take care of the engineering facultative reinsurance business both on the marketing side as well as on the underwriting or technical side (with only the supporting clerical staff working on a full-time basis along this line of business for the Hong Kong market)
- a gross facultative reinsurance premium income written by the branch office being around 5% of the total market gross engineering facultative reinsurance premium in Hong Kong, essentially all in proportional basis
- heavy losses being recorded for engineering facultative reinsurance in Hong Kong written by the branch office over the past three years

- typical marketing and underwriting support as well as typical assistance on other areas as explained earlier from the head office being available
- extensive experience on non-proportional engineering facultative reinsurance business being available in the head office although development of it being not very active in Hong Kong

Summary

Professional reinsurance companies play an active role in providing substantial facultative reinsurance capacity for the engineering insurance business in the market. Through the careful look at the set-up of a typical reinsurance company over the various areas including the marketing activities, underwriting activities and other activities, the Hypothetical Reinsurance Company under our study consists of essentially all the typical characteristics as mentioned above among his special historical background. Certain important advantages about the Hypothetical Reinsurance Company identified include his strong technical support through a local resident engineer, his strong financial background & capacity and his flexibility in providing coverage and terms.

In conclusion, the background information over the Hypothetical Reinsurance Company helps us to develop various marketing strategies over its strengths and

capabilities in offering the new product to satisfy the present identified needs of the large locally incorporated insurance companies.

CHAPTER IV

COMPETITIVE ENVIRONMENT ON NON-PROPORTIONAL FACULTATIVE REINSURANCE FOR ENGINEERING INSURANCE BUSINESS

The Hypothetical Reinsurance Company's Position

As the company is quite new to the Hong Kong market in terms of the short period of local operation, marketing network is limited. The market share of the traditional proportional facultative reinsurance for engineering insurance business is also limited.

Strengths

The following strengths can be identified:

- strong historical and financial background of the company, which give confidence to the insurance companies that the company will surely be able to pay off the claims no matter how large they can be
- strong technical advice on underwriting, claims handling, risk management and assessment being able to be provided in view of the availability of a local engineer
- provision of training facilities to the clients in Hong

Kong or in the head office

- flexibility in terms of insurance coverage and limits
- experience and support from the head office in terms of engineering facultative reinsurance on a non-proportional basis

Weaknesses

The weaknesses of the company include the following items:

- relatively new to the market
- inadequate experience in terms of pricing in the branch office in view of the lack of market statistics and experience on facultative reinsurance on a non-proportional basis

Direct Competitors

As the non-proportional engineering facultative reinsurance arrangement is considered to be very new to the market. Hence, we are going to look at those companies capable of providing capacity in this area.

The direct competitors in the market which can offer non-proportional engineering facultative reinsurance capacity for business in Hong Kong consist of the following two main categories:

- other reinsurance companies who have either local

representation in the market or not

- reinsurance brokers who may place risks to overseas markets including the Lloyd's syndicates located in London, etc.

Other Reinsurance Companies

There are around 25 reinsurance companies working on proportional engineering facultative reinsurance business in Hong Kong, which also have the potential to offer non-proportional engineering facultative reinsurance. However, there are only several active ones (around 4 in total including the hypothetical reinsurance company we are studying now and the other three companies which we name them as A Reinsurance Company, B Reinsurance Company and C Reinsurance Company respectively) in the sense that they provide a leading position on a lot of large cases with substantial participation. It is estimated that those active companies collectively occupy a total market share of around 45% and the remaining reinsurance companies also collectively share another 20%.

Basically, all the reinsurance companies have the facility to offer non-proportional engineering facultative reinsurance support in the insurance market, which heavily depends on the company philosophy whether to use it in the region or not.

A Reinsurance Company

A Reinsurance Company is locally represented by a branch office in Hong Kong over 25 years with strong financial background. They have good connections with most of the insurance companies in Hong Kong. They are viewed as the pioneer in providing proportional facultative reinsurance for engineering insurance business as well as in developing engineering insurance business in Hong Kong by first introducing the insurance policy form, the underwriting manuals and the rating guides to the insurance market. On the other hand, the clients are very dependent on their technical services and their strength in providing huge capacity. They have four engineers resident in the branch office who are capable to provide services including in-house training to their clients and one of them is solely working for the Hong Kong market. Their present market share of the proportional facultative reinsurance business is estimated at around 25%.

However, they are not very supportive to offer capacity on non-proportional engineering facultative reinsurance in the market as they tend to think that the insurers would easily reserve too little premium for the primary layer of any one engineering insurance policy issued, which may then lead the insurers into substantial financial suffering particularly when the frequency of claims is much higher than what they expected in the beginning. This is particularly significant in the Hong Kong market where most of the insurers do not have engineers to take care of this line of business and cannot

really have the right expertise to assess the true exposure of the risks. Actually they are suppressing this kind of arrangement in the market by only giving capacity on engineering facultative reinsurance in the market in proportional basis. But should their response be positive to the non-proportional reinsurance arrangement, the impact as well as the capacity they can exert on the insurance market should not be neglected at all.

In view of their good connections to essentially all insurers in Hong Kong which compete among themselves in the insurance market, flexibility in terms of their pricing on proportional engineering facultative reinsurance is lacking.

B Reinsurance Company

B Reinsurance Company is also operating through a branch office in Hong Kong. Their business connection is also well established through their long representation in Hong Kong and their strong financial background. Their market share of the proportional engineering facultative reinsurance business is estimated at around 10%.

They are also not very supportive to non-proportional facultative reinsurance arrangement in view of the same concern as noted above. Their possible capacity is also very substantial if they decide to use it.

However, they do not have an engineer in Hong Kong though they are supported by their head office and would

sometimes not be able to provide quick technical services to clients.

C Reinsurance Company

C Reinsurance Company is very comparable in size to the hypothetical company although they have had representation in Hong Kong for a period of 15 years longer. Their business connection with clients is also very close. They have an engineer resident in Hong Kong to take care of the business and to provide technical service. Their market share of the proportional engineering facultative reinsurance business is estimated at around 5%.

They are not so opposing to the idea of non-proportional engineering facultative reinsurance as A Reinsurance Company and B Reinsurance Company. However, they are not very active in pushing the non-proportional engineering facultative reinsurance business but they still exert pressure in the market if they decide to follow.

In view of the poor results over the years on the engineering insurance business, they have reduced their involvement on this market but in a way, they still exert some influence.

Reinsurance Brokers

The reinsurance brokers would increase the competitiveness of the market in view of the following factors:

- their ability to find some markets which are not so knowledgeable about the experience of the market and hence accept very under-rated or exceptionally exposed risks as long as the premium volume being very substantial, such as the London market, etc.
- their ability to arrange a good reinsurance programme which is both acceptable to the insurers as well as the reinsurers, particularly the non-proportional engineering facultative reinsurance programme

The aggregate total market share of the proportional engineering facultative reinsurance business is estimated at around 25%.

Their potential role is very substantial in pushing for non-proportional engineering facultative reinsurance in view of their prior experience accumulated on this type of business in other regions and their easy access to the capacity in the worldwide market. They can also be very close to the insurers to know their need and can really incorporate their ideas, such as on the maximum acceptable level of retention (primary layer) that the insurance companies are willing to take, to structure the layering of the reinsurance programme and then to find different markets (both local and overseas) to accept all the layers. The way they do it is through requesting several leaders to provide leading terms and conditions for different layers. The lowest possible quotation for

each layer with full followers markets found will be accepted provided that the insurers are satisfied with the financial security of all the participants. The whole reinsurance programme is completed as long as all the layers are completely placed. Sometimes, they can also provide technical risk management service to the insurance companies.

Indirect Competitors

The indirect competitors in the market which would only offer proportional engineering facultative reinsurance support and would be considered to be incapable to offer non-proportional engineering facultative reinsurance in view of their limited facilities include the following two categories:

- underwriting agencies who have binding authorities to write business on behalf of some overseas insurers
- insurers who write reciprocal exchange business (i.e. the exchange of business between two insurers), which they do not usually have business contacts or write on a direct policy issuing basis

Underwriting Agencies

Their influence on the overall market competitiveness is usually small because of the following reasons:

- a relatively lower underwriting authority available as

compared with that of the reinsurance companies

- a stricter underwriting approach which is usually imposed by their principals behind their authority as their authority would easily be cancelled if there are several years of poor results

The aggregate total market share of the proportional facultative reinsurance business is estimated to be less than 5%.

Their direct competition in offering non-proportional engineering facultative reinsurance is very minimal in view of their lack of technical expertise as well as capacity.

Insurers

The capacity provided in the market via reciprocal exchange of business is relatively small as there are certain difficulties to overcome, such as to make sure that the quality of business offered to each other is similar so that the eventual results in terms of profitability are similar for the two insurers concerned. The exchange of business is usually restricted on a proportional engineering facultative reinsurance basis as insurers are usually incapable to provide non-proportional engineering reinsurance support by giving the appropriate terms and conditions.

The aggregate total market share of proportional facultative engineering reinsurance business is estimated at around 5%.

Business placed on a non-proportional facultative reinsurance basis is also very minimal similarly in view of their lack of technical expertise as well as capacity.

Competitive Dynamics

Pioneering Advantage

A Reinsurance Company is certainly having the pioneering advantage in the market in terms of traditional proportional engineering reinsurance and has built up the loyalty of his clients. However, he is losing his competitiveness in view of the failure of satisfying special requirements from some clients, say for more competitive prices.

On the other hand, by introducing a package of non-proportional engineering reinsurance arrangement acceptable to the insurers, the Hypothetical Reinsurance Company can obviously secure a substantial advantage in establishing its name as a pioneer on this relatively new product.

Technological Discontinuities

As types of engineering insurance policies do not vary very much recently, hence the forms of reinsurance

remains essentially the same.

Only special exclusions under the policies are expected to be covered again that imposes certain pressure on the reinsurers to accept and to quote a price. However, the situation will only happen when the exclusions being covered again do not violate the insurance principles. Hence, the matter will be resolved only as a matter of price. In that case, flexibility over pricing is very important.

New Market Entrants

Essentially there are only very few barriers to enter into this market including the following:

- lack of access to insurers
- insurers' loyalty to existing reinsurance companies, underwriting agents, reinsurance brokers or other insurance companies
- lack of financial security
- lack of technical expertise on this line of business

The lack of technical expertise will play a particularly substantial role in deterring new comers to the non-proportional facultative reinsurance market.

Intensity of Competition

Overcapacity

As there are a lot of players in the market which have already built up their connections, reputation and technical expertise with the insurers. Severe competition among local reinsurance companies and companies in the London market is most dominant on proportional engineering facultative reinsurance. Moreover, the situation is even worsen by the potential growth of the market for the new airport construction project as well as related building development contracts.

Most of the capacity available for proportional engineering facultative reinsurance as explained earlier (mainly from the direct competitors) can easily be converted to be used as non-proportional facultative reinsurance. The situation of overcapacity can still occur on non-proportional engineering reinsurance market.

Different Underwriting Philosophies and Experience

As the acceptance of a risk is heavily dependent on the underwriter's judgment which eventually relies on the underwriting philosophy and experience of that company, hence unintentional competition in terms of price and coverage is created in view of the different attitudes of the two different underwriters on the same risk.

The situation will be even more serious in the case of non-proportional reinsurance in view of the lack of

market statistics and experience. Underwriters may tend to rely on the worldwide experience (through the support of their head office, etc.) to provide quotations.

Products and Services Offered

By neglecting the response time, essentially every company can provide technical support via its own head office (particularly the reinsurance companies) in terms of a leading quotation and/or risk management advice though up to a different extent on a local service basis. The products and services provided by the followers market are essentially undifferentiated too.

For non-proportional facultative reinsurance, local services are more heavily stressed in view of the fact that the product will be quite new to the insurers. More technical advice and services will be required from time to time. Reinsurance companies as well as reinsurance brokers having a local representation will have a definite advantage in offering quicker and better services.

Low Cost in Shifting from One Security to Another

As long as a company is considered as financially sound, the insurer will be pleased to give the business to that company at the same terms and conditions as he gives to others.

This is essentially the same for business placed in

proportional basis or non-proportional basis.

Long Period to Gather Experience

As a construction contract can easily last for five years, the final experience will only be possible to be gathered after five years. Within these five years of time, many changes can occur and affect the true pricing of the insurance contract. This uncertainty adds one very important factor to competition.

This is extremely important to non-proportional quotation as the lack of market experience. Different companies will definitely quote differently if they place different safety factors on the price depending on the length of time (long or short) and the area (large or small) of market experience that they can gather.

Summary

The strengths and weaknesses of the Hypothetical Reinsurance Company are carefully analyzed. The direct competitors including other reinsurance companies and reinsurance brokers are also studied. Three reinsurance companies exerting major threats to the Hypothetical Reinsurance Company have been picked up for our study, in particular over their present market influence and their potential threats to the Hypothetical Reinsurance Company over the offer of the non-proportional facultative reinsurance in the market. Similarly, reinsurance brokers can

also exert high potential threats to the Hypothetical Reinsurance Company. The indirect competitors, including underwriting agencies and insurers, can exert minimal threats in view of their limited expertise and capacity available.

Further analysis over the competitive dynamics and intensity of competition is performed. In respect of the competitive dynamics, the Hypothetical Reinsurance Company can obviously obtain the pioneering advantage if it is going to introduce the new product to the market. However, barriers to new entrants are limited, particularly over the direct competitors, and the basic form of the product remains the same. On the other hand, intensity of competition is severe in view of overcapacity in the market, different underwriting philosophies and experience over rating exercises, quicker products and services offered, low cost in shifting from one security to another and long period to gather experience.

In conclusion, competition will be anticipated to be rather severe if the competitors, particularly the direct ones, follow the act of the Hypothetical Reinsurance Company.

CHAPTER V

DEVELOPMENT OF SEVERAL ESSENTIAL COMPONENTS ABOUT THE LAUNCH OF THE NEW PRODUCT - THE NON-PROPORTIONAL FACULTATIVE REINSURANCE ON ENGINEERING INSURANCE BUSINESS

General

Before the full marketing plan for the launch of the new product is to be derived, there are several essential components that we would like to know more, particularly about the reactions of the insurance companies within our target market over the new product.

Based on the detailed analysis performed over previous chapters on the market opportunities, the potential profile of insurers, the Hypothetical Reinsurance Company and the competitive environment for the non-proportional facultative reinsurance on engineering insurance business, the specific areas we would like to concentrate on to develop in order to assist the launch of the new product to suit the particular needs of the large incorporated insurance companies within our target market are as follows:

- product characteristics

- product pricing
- product promotion activities
- product sales force
- product distribution

Product Characteristics

The overall objective is to build up the users' confidence and satisfaction over the new product, which can be as the existing product form (already used in other markets, like London, etc.) but introduced to a new market, Hong Kong, in particular to the large locally incorporated insurance companies in Hong Kong. In view of the newness of the product to those insurance companies, a lot of educational work are anticipated. Nevertheless, well acceptance of the product to the insurance companies still can not be assured.

The whole product package (as a financial product) should have possessed the following properties:

- it has to be fully backed up by good and financially sound security
- it has to be fully backed up by good underwriting capacity and technical capabilities
- it should be flexible particularly in terms of coverage and other conditions

- it should attain the normal properties of non-proportional facultative reinsurance
- it should go together with technical services, both on engineering and insurance matters, and should be packaged together
- the technical services can further be extended to include the assistance to the insurance companies to set up proper engineering or specialized underwriting department in order to improve the overall quality of business accepted, to improve their risk control capability and to enable them to retain the primary layer of the non-proportional facultative reinsurance arrangement through correct pricing
- the further improvement and development of the product should be made available, particularly at the Hypothetical Reinsurance Company's head office level, where extensive research and analysis work can be performed

Product Pricing

The pricing objective is basically selective-demand-based in order to encourage the insurance companies to buy the product. As the market demand is considered to be inelastic (while the insurance companies in any case have to arrange facultative reinsurance whenever the sum insureds of risks they insure exceed their automatic facility) and the company demand is elastic, parity

pricing programme is considered appropriate, which is to set prices at or near competitive levels, particularly considering that the competitors (other reinsurance companies or reinsurance brokers) can easily match the prices and compete if they wish to do so. The programme is quite suitable to be used for the new product we consider over the existing product particularly when the costs involved in terms of time and resources involved in underwriting, claims handling, general administration, etc. can be lower.

Basically, the product's price has to be worked out according to the careful analysis of each risk offered. Nevertheless, the following factors should be taken into consideration in the pricing exercise:

- to find out the possible loss profile of the risk under consideration so that the more accurate pricing of each layer of the non-proportional reinsurance arrangement is possible, particularly over the higher layers where the insurance companies definitely require support
- to understand the nature of risks under consideration as a comparison with those risks already reinsured before or the market statistics obtained locally or globally so that possible loss profile can be adjusted according to the experience
- to study the market conditions from time to time to know what the competitors are doing as price can be considered as a very important factor influencing the

purchase intention of the insurance companies

Product Promotion Activities

The promotion activities can be classified into three sections as follows:

1) Advertising

The main objective is to make awareness of the Hypothetical Reinsurance Company in terms of his historical background, financial soundness, underwriting capacity, technical capabilities, company philosophy and technical details about the product to the insurance companies to eventually to build up their full awareness of the product as well as their brand loyalty (through the pioneering advantage of introducing this new product).

The areas to be considered for implementing an advertising programme include the following:

- the message design including the appeals and the method of presentation to be used
- the media such as newspapers and magazines, which are considered as more appropriate, to be picked up
- the overall cost-effectiveness of the programme, particularly considering the number of companies possibly having benefits from the programme

2) Sales promotion

The essential objective is to create more inquiries from the insurance companies, which would possibly lead to more using of the Hypothetical Reinsurance Company's services, more exchange of views, a better understanding of the product and hopefully more conclusion of business.

The product should well be promoted through the following activities at different levels:

A) Hypothetical Reinsurance Company's head office, regional office and branch office

- to conduct lectures or seminars on a whole market basis or on an individual in-house basis to update the information about the product on a global perspective on product development, etc.
- to provide some subsequent in-house or overseas training programmes to the underwriters as a further reinforcement
- to prepare and distribute some product publications to supplement the above training exercises

B) Hypothetical Reinsurance Company's regional office and branch office

- to provide some in-house training programmes to the underwriters to draw their particular atten-

tion to product in the region or in Hong Kong

- to distribute some product publications to the underwriters providing technical guidelines in general to be used in the region or in Hong Kong
- to keep constant contacts through courtesy visits or telephone calls with the underwriters providing continuous technical services in terms of underwriting, claims handling, risk management and assessment, accounting, etc.
- to pay regular visits to the insurance companies collecting feedback comments or complaints over the product or services

Nevertheless, the overall cost effectiveness of the activities have to be considered and justified.

3) Public relation

The objective is to create more communication channels between the insurance companies and the Hypothetical Reinsurance Company.

The areas to be specially considered include the following:

- to pay particular attention to the activities of the insurance companies through sending out cards in Christmas or the new year, advertising in the newspapers or magazines for celebrating their

anniversaries, etc.

- to send company gifts to the insurance companies
- to give donations to the insurance associations to establish the Hypothetical Reinsurance Company's market image
- to provide special papers over specific technical topics in insurance magazines also to establish the Hypothetical Reinsurance Company's market image
- to held regular formal (like cocktails) or informal (like short drinks after the normal office hours) gatherings to build up personal relationship

Similarly, the overall cost effectiveness of the above activities have to be considered and justified.

Product Sales Force

In addition to providing good security and capacity, technical services have to be delivered by qualified personnel, in particular engineers, who can understand the exposure of the risks through their prior technical knowledge as well as engineering experience attained. The overall objective is to provide adequate (in terms of quantity) and competent (in terms of quality) staff to serve the insurance companies.

Hence, logically there are some derived factors to

be picked up as follows in order to provide adequate services in the areas of underwriting, risk management and assessment, claims handling, engineering training lectures and seminars, etc.:

- to have at least one local engineer, who should have prior engineering working experience and should obtain subsequent insurance knowledge, to provide the technical services required
- to acquire technical support from the Hypothetical Reinsurance Company's head office

Again overall cost has to be evaluated against the benefits herein derived.

Product Distribution

In respect of product distribution, the overall objective is to assist the insurance companies to secure more business through the reinsurance protection arrangement by this product.

The following items are specifically looked at as follows:

- to extend the technical services provided by the Hypothetical Reinsurance Company to the direct brokers or the agents (who produce business to the insurance companies) or even the insureds
- to provide a quick and efficient reply based on the

minimal information required for full technical assessment of the risk to improve the overall competitiveness of the insurance companies

- to strengthen the capabilities of the insurance companies' engineering or specialized team to control the network of business for securing large accounts

Summary

The basic factors affecting the final marketing plan for the launch of the new product are identified in respect of the areas on the product characteristics, the product price, the product promotion activities, the product sales force and the product distribution respectively. These factors are very important as a start for the later testing of the response of some selected customers.

CHAPTER VI

QUESTIONNAIRE SURVEY AND FINDINGS

Questionnaire Survey

Based on the analysis over the several essential components of the new product developed in the last chapter, a questionnaire was specially designed to test the importance of the information from a small sample of locally incorporated insurance companies through intensive private interviews. The questionnaire is attached in Appendix 1.

The areas of concentration of the questionnaire fall in the five areas as follows:

- product characteristics
- product price
- product promotion activities
- product sales force
- product distribution

Eventually, four representatives from four different locally incorporated insurance companies were inter-

viewed. The relevant findings are recorded hereunder. The analysis is also classified respectively into five areas following the design of the questionnaire.

Findings

Product Characteristics

Characteristics of the reinsurer offering the new product

The basic ideas from all the interviewees that the financial security, the underwriting capacity, the technical capabilities and the availability of coverage are all very important characteristics of a reinsurer offering the new product. The financial security is also considered the most important and the availability of coverage is considered the least important.

The general reasons supporting their answers are summarized as follows:

- if the reinsurer is financially strong, he can afford to pay the losses, no matter how big those losses can be
- the underwriting capacity should be important as the insurers would heavily rely on the reinsurer's quotation, which should go with a very substantial participation at the beginning
- the reinsurer has to acquire the technical capabilities to analyze the risk before he can offer the product and

also to give other reinsurers' confidence to follow to participate

- the availability of coverage can give definite benefits to the reinsurer

Services going together with the new product

All the interviewees consider that the assistance offered by the reinsurer to the insurers to set up a proper engineering or specialized underwriting department to improve risk control and pricing capability is very important. The main reasons are as follows:

- the insurers can better understand the risk and more importantly, can calculate a correct price for the primary layer
- the insurers can receive professional support from the reinsurer

The technical services are viewed less important. The main reasons are as follows:

- the insurers want to keep the final control

Nevertheless, the technical services are still valued to a certain extent that the insurers can have access to the technical support from the reinsurer, when necessary.

The further product development is considered not

important at all. The main reason is that the new product is still too new to consider whether it can be accepted in the market and further product development can be useful.

Product Pricing

Factors affecting the new product pricing

Basically, all the five factors listed within this question are considered as important.

The approximate ranking of importance of the five factors are as follows:

- the possible loss profile of the risk
- layering arrangement of the new product
- the previous loss experience of similar risks in a local or global basis
- other prices available in the market for the new product
- flexibility of the reinsurer offering the price of the new product

The main reason for the importance of the first three factors above is that all these factors give technical background to work out the new product pricing. However, the importance of the remaining two factors

rests with the market competition situation. The insurers usually have a practice to check prices in the market, which they consider important. Hence, the flexibility of the reinsurer would become also important, so that his price can match the market prices.

Product Promotion Activities

Advertising

The normal advertising programmes are considered not very suitable and useful, particularly in view of limited number of insurers in the market. The information about the important characteristics of a reinsurer as well as the product's benefits and costs should better be conveyed to the insurers through personal contacts.

However, if an advertising programme is still decided to be used, the message design including the appeals and the method of presentation is considered important to achieve the intended purpose to advertise the important characteristics of a reinsurer as well as the product's benefits and costs. The appeals play an important role in presenting the above information in easily comprehensive form. The method of presentation should better be in graphical and written form.

Moreover, the media is also considered important. The most acceptable form seems to be insurance magazines.

Sales promotion

Ideas are diversified on whether the services in question can induce more inquiries from the insurers to the reinsurer concerning the new product. In general, services delivering more personal and extensive contacts would receive the most appreciation, such as the provision of in-house or overseas training programmes, the conduct of lectures or seminars on a whole market basis or an individual basis, the making of telephone calls and the paying of visits. On the other hand, services in the form of less personal would receive the least appreciation, such as the giving out of product publications.

The approximate ranking of importance is as follows:

- providing local or overseas training programmes
- conducting lectures or seminars on a whole market basis or an individual in-house basis about the product on a global or local perspective
- making telephone calls
- paying visits
- giving out product publications in a global or local perspective

Public relation

Holding formal or informal gatherings is considered important and giving donations to insurance associations is considered not important at all by all the interview-

wees to create communication channels between the insurers and the reinsurer. The main reason for the choice is that the former function is more personal and of value.

The approximate rank of the importance of the six factors in question is as follows:

- holding formal or informal gatherings
- writing special papers in insurance magazines
- sending out cards in Christmas or the new year
- sending out company gifts
- advertising in the newspapers or magazines for celebrating an insurer's anniversary, etc.
- giving donations to insurance associations

Product Sales Force

Support from the reinsurer

All the interviewees consider that the availability of a local engineer as well as back-up support from the parent office of the reinsurer are very important in providing adequate support on the sales force over the introduction of the new product. The main reasons for the importance of the availability of a local engineer are as follows:

- the local engineer can give strong technical support

- the easy accessibility of the support
- the local engineer's understanding over the local market

The importance of the availability of back-up support from the parent office of the reinsurer rests with the situation when the local engineer fails to provide adequate support on some areas.

Nevertheless, the local scene is considered to be more important, hence the ranking of importance logically follows as below:

- availability of a local engineer
- availability of back-up support from the parent office

Product Distribution

Activities from the reinsurer

Provision of a quick and efficient reply based on minimal information obtained as well as strengthening of the insurers' capabilities to secure the network of business over large accounts are both considered important by all the interviewees in supporting the insurers to acquire business from the network. The main reasons for the importance are as follows:

- quick response is important in view of particular pressure from the market

- large accounts would attract high capacity, particularly to be available from the reinsurer

However, provision of the reinsurer's services to the direct brokers, the agents or the insureds is not considered important. The main reason is that the contacts to the direct brokers, the agents or the insureds should be restricted to be made by the insurers only, not by the reinsurer.

The approximate ranking of importance of the above different factors is as follows:

- provision of a quick and efficient reply based on minimal information obtained
- strengthening of the insurer's capabilities to secure the network of business over large accounts
- provision of the reinsurer's services to the direct brokers, the agents or the insureds

CHAPTER VII

FINAL MARKETING PLAN FOR THE LAUNCH OF THE NEW PRODUCT

- THE NON-PROPORTIONAL FACULTATIVE REINSURANCE

FOR ENGINEERING INSURANCE BUSINESS

Marketing Objective And Strategy

Marketing Objective

From the market opportunities analysis, it is noted that primary demand for facultative reinsurance exists and tends to increase in view of the trend of increase in proportion of larger and more complex accounts. Companies are more attracted to buy the new product when business growth in a professional way through more input of resources and improvement of business quality to bring about long term profitability is their hidden belief. The new product can give the capacity required to the insurance companies at a lower reinsurance cost, which they can afford to pay and at the same time can retain more insurance premium for their net account. The new product fits very well the concept of those companies in improving the cost-effectiveness of the facultative reinsurance arrangement by only asking supports from reinsurance sellers for larger accounts, where capacity

is required, as well as in improving the business quality by the imposition of higher excesses.

Moreover, from the potential customer profile analysis, it is discovered that three large locally incorporated insurance companies have generated around 20% of the whole market gross insurance premium on the engineering insurance business and are expected to get substantial involvement in the market in the future years to come in view of their present respective market positions (though competition from other insurance companies, particularly those foreign incorporated insurance companies with strong automatic facility provided by their parent companies, remaining very strong). Basically the insurance companies are lacking of technical support from in-house engineers to select better business and to control the quality of business. The advantage of competitive prices on better business will also be very important. Moreover, constant turnover of staff within the insurance company will certainly affect the quality of business underwritten (particularly if without the constant and steady support from reinsurance sellers) as they are too heavily relying on one or two persons to take care of the business. The results have not been very satisfactory for the past several years.

However, from the Hypothetical Reinsurance Company analysis, it is shown that in view of the relatively short period of local representation, the Company only manages to secure a small share of the whole traditional

proportional facultative reinsurance market for engineering insurance business. However, it has equipped itself with basically all the advantageous characteristics of a professional reinsurance company and has further enhanced its strength through its special company set-up of a local office as well as a regional office in Hong Kong. Adequate resources have been injected in the local area, including the employment of a local engineer, to give full support on the implementation of both its marketing activities and underwriting activities with a quick and quality response. Direct support and linkage with the head office are also well established. Nevertheless, heavy losses have been recorded by the Company along this line of business for the past three years, which follows the same trend of the direct insurance market and also prepares the Company for the offer of a new product to the market satisfying the present needs of the large locally incorporated insurance companies.

Finally, from the competitive environment analysis, it is found out that the major competitors, in particular the A Reinsurance Company, share substantial portions of the whole traditional proportional facultative reinsurance market and share similar strengths as the Hypothetical Reinsurance Company. The possible weak point identified is their lack of flexibility in the prices in view of their long term connection with most of their clients, which are competing with each other on most of the cases. The present traditional proportional facultative reinsur-

ance market is filled with surplus capacity from various sources both local and abroad, particularly in London, which can easily be converted to capacity for the new facultative reinsurance product. Most of the direct competitors, except reinsurance brokers, take a cautious attitude towards the promotion of the new product. As pricing of the new product is extremely important, the companies that can offer quicker and better technical services will definitely have an advantage over the others both in terms of competition and profitability.

In view of the above, there is a great potential of success for the Hypothetical Reinsurance Company to provide the right resources and support to the implementation of a new non-proportional facultative reinsurance product in order to satisfy the needs of the insurance companies in the target market to develop a profitable and growing portfolio through improvement of technical knowledge and also at the same time, in order to bring about profits from deficits as well as larger market share to the Hypothetical Reinsurance Company in the next five years as well as in the longer term.

Marketing Strategy

From the analysis of the findings of the questionnaire survey, the marketing strategy of the Hypothetical Reinsurance Company to acquire larger market share of business, particularly in the target market, as well as

to turn deficits into profits through the differentiated positioning in the market can be done by:

- providing the new product, the non-proportional engineering facultative reinsurance, through his strengths and capabilities, particularly in offering the services to assist the insurance companies to set up a proper engineering or specialized underwriting department as well as the other technical services
- providing technical as well as competitive prices of the new product
- providing tailor-made sales promotion activities in more personal forms
- providing technical support from the local engineer as well as the parent office
- providing quick and efficient reply as well as strengthening of the insurance companies' capabilities to secure large accounts

Product Objective And Strategy

Product Objective

The product objective is to build up the insurance companies' confidence and satisfaction on the new product offered by the Hypothetical Reinsurance Company through the awareness of the special characteristics of the Company and the offering of its technical services.

Product Strategy

The new product, the non-proportional engineering facultative reinsurance, should be offered together with the special characteristics of the Hypothetical Reinsurance Company (which have particular inherent strengths in offering this new product) as well as its technical services including the assistance to the insurance companies to set up a proper engineering or specialized department, in the form of a full package basis. It should be launched as a product development as compared with the traditional product form to provide different user attributes to satisfy the special needs of the large locally incorporated insurance companies.

Ability to provide further product development, after initial implementation, should be made available although it is not highly desirable at this stage.

Product Pricing Objective and Strategy

Product Pricing Objective

Product pricing objective is selective-demand-based, which can enable to offer a low-price alternative to meet competition, particularly when the potential of competition can be severe after the launch of the new product.

Product Pricing Strategy

Although the pricing exercise is heavily based on technical basis through the analysis of the possible loss profile of risks, layering arrangement of the new product and the previous loss experience of similar risks, flexibility has to be built in to meet the possible competition.

Prices have to be set near the competitive level to avoid the possible entry of competitors as there can be a lot of possible sellers of the new product, like other reinsurers (if they decide to follow to offer this product) and reinsurance brokers, and there is low cost in shifting from one company to its competitors. Moreover, correct pricing will never be obtained in view of the lack of local statistics as well as different underwriting philosophies and experience of each reinsurer, which eventually increase the possible level of price competition. Product differentiation can obviously established if the customer loyalty can be created, which can allow higher prices to be charged for the new product. However, a balance has still to be obtained between the two, where the flexibility becomes important.

The pricing positioning should be emphasized to maximize the long term profit as well as to achieve a long run survival situation. Moreover, through the competitive pricing, substantial market share can be anticipated, particular in view of the unsatisfied needs of the insurance companies being satisfied by the new product

and the pioneering advantage. Future potential gains and substantial growth can also be enhanced through future market expansion.

The gathering of valuable experience can also be a very important asset for the refinement of future pricing exercises when the experience can improve the overall pricing exercise. The resultant effect would enhance the competitiveness of the prices to be offered.

Product Promotion Objectives and Strategies

Product Promotion Objectives

Product promotion objectives can be classified into three different areas, namely advertising, sales promotion and public relation respectively.

Advertising objective

Advertising objective is to keep the insurance companies aware of the special characteristics of the Hypothetical Reinsurance Company, including its historical background, financial soundness, underwriting capacity, technical capabilities and company philosophy on coverage, and the details of the new product, and eventually to create a brand loyalty.

Sales promotion objective

Sales promotion objective is to induce more in-

quiries from the insurance companies, which lead to more using of the Hypothetical Reinsurance Company's services, more exchange of views, better understanding of the new product and eventually more conclusion of business.

Public relation objective

Public relation objective is to create more communication channels between the insurance companies and the Hypothetical Reinsurance Company.

Product Promotion Strategies

Similarly, the strategies can be classified into the following three corresponding areas.

Advertising strategy

The cost effectiveness of an advertising programme is considered not very positive, particularly in view of the limited number of insurance companies in the market to be covered. More efforts should be put to the following two areas to promote the new product instead.

Nevertheless, to advertise the special characteristics of the Hypothetical Reinsurance Company and the details of the new product in insurance magazines through graphical and written form of presentation, mostly over an one-off situation, should not be neglected.

Minimal expenses should be involved.

Sales promotion strategy

Services offered through more personal and extensive contacts are emphasized although it is understood that different people may react differently. A wide range of programmes is to be considered to suit the tastes and preferences of different people although costs should be carefully measured and controlled.

Local or overseas training programmes can be arranged for selected individuals, particularly for those underwriters, executives or managers (of the reinsurance, engineering or casualty departments) heavily involved in the decision making process in using the Hypothetical Reinsurance Company's services, from different insurance companies. Programmes should be more concentrated on passing the product knowledge to the participants and arousing their interest in using the new product as well.

Lectures or seminars can also be conducted on a whole market basis or an individual in-house basis. Engineers from the parent office as well as the local office can be gathered to perform a joint or individual programme depending on the nature of the seminar and the composition of participants. Market wide seminars should better be held by engineers from the parent office when in-house seminars should be better held by the local engineer, to achieve different levels of confidence of the participants over the Hypothetical Reinsurance Company's local as well as back-up services.

Commonly, telephone calls and regular visits should be made from time to time, in order to keep the contacts with the underwriters, executives or managers of the relevant departments of the insurance companies to provide continuous services. Upgrade of services should be provided over any possible areas of complaints.

Product as well as company publications in written and graphical form of presentation and the information about the product further development should be made available to be distributed to the insurance companies.

The expenses involved in the above programmes should be justified by the anticipated increase of turnover and profitability.

Public relation strategy

Communication channels between the insurance companies and the Hypothetical Reinsurance Company can be established through various methods.

Formal or informal gatherings should be considered as the most effective means in maintaining close human relationship. Other ways including writing special papers in insurance magazines, sending out cards in special seasons, sending out company gifts and advertising in the newspapers or magazines celebrating an insurance company's special events can also be considered to contribute positive effects to a different extent.

The expenses involved should also be justified

similarly by the anticipated increase of turnover and profitability.

Product Sales Force Objective and Strategy

Product Sales Force Objective

Product sales force objective is to provide adequate (in terms of quantity) and competent (in terms of quality) sales force to support the services over the new product.

Product Sales Force Strategy

The availability of a local engineer has really provided the necessary technical services in terms of both engineering and insurance matters to support the new product. The local engineer has had prior engineering knowledge as well as working experience in engineering disciplines, and was subsequently trained over insurance aspects. Technical and market knowledge can also be accumulated from time to time so that more valuable services in terms of underwriting, claims handling, risk management and assessment, training and marketing can be provided to the insurance companies in a more easily accessible and local approach, through the promotion activities as mentioned above. At the same time, the establishment of close personal relationship should also be stressed to build up a distinct identity of the engi-

neer to the insurance companies.

Support from the parent office should also be emphasized, in view of their stronger technical support through more experience over the new product, particularly in the global context.

Consultative selling approach is used to handle the business by allowing the engineers to go through all the underwriting steps with the insurance companies in order to work out the reinsurance protection programme, which can assist the insurance companies to sell the insurance policies. Assistance can further be given by the engineers to the insurance companies to set up a proper engineering or specialized underwriting department to improve the risk control and pricing capability as mentioned before.

Marketing work can also be assisted by other executives in the local office as well as in the regional office. All accounting and administrative work would be handled by supporting staff.

The major expenses involved are mainly related to the salaries of the engineers among other staff. The costs have to be justified by the anticipated increase of turnover and profitability.

Product Distribution Objective and Strategy

Product Distribution Objective

Product distribution objective is to assist the insurance companies to acquire business from the existing network as far as possible through the support of the new product.

Product Distribution Strategy

As the new product itself would not be finally consumed by the insureds, there is no real process of direct product distribution from the Hypothetical Reinsurance Company to the insureds. However, the new product can also be viewed as a very important component of the final product consumed by the insureds and can help to shape the final product, particularly over the areas of insurance coverage and prices.

The services are stressed to be provided in a very quick and responsive way, particularly based on minimal information obtained on hand, in order to keep the insurance companies satisfied in a way to grab the market opportunities and to gain advantages in the competition.

The strengthening of the insurance companies' capabilities, particularly in terms of technical ability, to secure the network of business over large accounts via different sources, such as direct brokers, agents or insureds, should be ensured. The new product is particularly good for large accounts, which are also targeted by the insurance companies. As mentioned before, this exer-

cise can particularly be done by the set up of a under-writing or specialized department in insurance companies to handle the business, with full technical support from the Hypothetical Reinsurance Company. The costs involved by the insurance companies to handle the business would be highly reduced in view of their improved knowledge and assistance from the Hypothetical Reinsurance Company.

CHAPTER VIII

CONCLUSIONS

In order to make the marketing plan work, all the strategies involved have to be coordinated to achieve a common goal to satisfy the present needs of the large locally incorporated insurance companies and at the same time to bring profitable and growing portfolios of engineering insurance and reinsurance businesses to the insurance companies and the Hypothetical Reinsurance Company respectively in a longer term. The timing of the implementation of the strategies can be different or overlapping but must work in a coherent approach in order to achieve the maximum efficiency.

Moreover, a control programme should be established to constantly review the outcome of the strategies to see whether the relevant objectives can be achieved. The actual costs involved in implementation of all the strategies should also be monitored from time to time over definite time intervals to ensure that it would not exceed the profits it can bring in a longer term.

Market situation changes from time to time, all the objectives should be reviewed regularly to see whether they are still good for that particular time frame under

review. Important areas requiring close supervision include the following:

- market competition, particularly over the reactions of major competitors, like other reinsurers and reinsurance brokers
- market opportunities, particularly over the any possible changing needs of the insurance companies within the target market
- major developments over the final product consumed by the insureds

Finally, the success of the marketing plan relies heavily on the full support of all the parties involved and the right control to face the changing market conditions.

APPENDIX 1

QUESTIONNAIRE SURVEY

Before the following questions are forwarded to the representatives of the chosen locally incorporated insurance companies in Hong Kong, the clear definition as well as the general operation of the new product (the non-proportional facultative reinsurance on engineering insurance business) that we are going to discuss will be given first.

The basic flow of the questions is to ask the interviewees how they perceive the importance of the factors in question together with their reasons for supporting their answers and to ask them also to rank the importance of the factors within each category afterwards (Note: Order of the choices are randomly altered for each question set to avoid effect of bias.).

Product Characteristics

A. How you would consider the importance of the following characteristics of a reinsurer offering this new product

- financial security

- underwriting capacity
- technical capabilities
- availability of coverage

B. How you would consider the importance of the following services going together with this new product

- technical services, in terms of engineering and insurance matters
- assistance to the insurers to set up a proper engineering or specialized underwriting department to improve risk control and pricing capability
- further product development

Product Pricing

A. How you would consider the importance of the following factors to the new product pricing

- layering arrangement of the new product
- the possible loss profile of the risk
- the previous loss experience of similar risks in a local or global basis
- other prices available in the market for the new product
- flexibility of the reinsurer offering the price of

the new product

Product Promotion Activities

Advertising

- A. How you would consider the importance of the following factors in achieving the intended purpose to advertise on a reinsurer's historical background, financial soundness, underwriting capacity, technical capabilities and company philosophy on coverage, which can then create full product awareness and brand loyalty from the insurers
- message design including the appeals and the method of presentation
 - media

Sales promotion

- A. How you would consider the importance of the following services delivered by a reinsurer to induce more inquiries from the insurers, which in turn lead to more using of the reinsurer's services, more exchange of views, a much better understanding of the product and more conclusion of business over the new product, particularly during the introduction stage

- conducting lectures or seminars on a whole market basis or an individual in-house basis about the product on a global or local perspective
- providing local or overseas training programmes
- giving out product publications in a global or local perspective
- making telephone calls
- paying visits

Public Relation

A. How you would consider the importance of the following activities performed by a reinsurer in creating more communication channels between the reinsurer and the insurers

- sending out cards in Christmas or the new year
- advertising in the newspapers or magazines for celebrating an insurer's anniversary, etc.
- sending out company gifts
- giving donations to insurance associations
- writing special papers in insurance magazines
- holding formal or informal gatherings

Product Sales Force

A. How you would consider the importance of the following factors about a reinsurer in providing adequate support on the sales force over the new product

- availability of a local engineer
- availability of back-up support from the parent office

Product Distribution

A. How you would consider the importance of the following activities performed by a reinsurer in supporting the insurers to acquire business from the network

- provision of the reinsurer's services to the direct brokers, the agents or the insureds
- provision of a quick and efficient reply based on minimal information obtained
- strengthening of the insurer's capabilities to secure the network of business over large accounts

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